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RR RUEHWEB

DE RUEHTH #1583/01 3001515
ZNR UUUUU ZZH
R 271515Z OCT 09
FM AMEMBASSY ATHENS
TO RUEHC/SECSTATE WASHDC 0906
INFO RUEATRS/DEPT OF TREASURY WASHINGTON DC

UNCLAS ATHENS 001583

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E.O. 12958: N/A
TAGS: [ECON](#) [ECIN](#) [PREL](#) [GR](#) [EFIN](#)
SUBJECT: SENIOR GREEK BANKER COMMENTS ON GREEK ECONOMY, NEW
GOVERNMENT, BANK HEALTH

REF: A. ATHENS 1581; B. ATHENS 1451; C. ATHENS 371; D. ATHENS 339
[1](#)E. ATHENS 216; F. ATHENS 176; G. 08 ATHENS 1655; H. 08 ATHENS 1515

SUMMARY

[1](#)1. (SBU) In a recent conversation with DepEconCouns, Nikolaos B. Karamouzis, the Deputy Chief Executive Officer of Eurobank EFG, Greece's second largest private bank in terms of both deposits and assets, discussed his views on Greece's economic and budget situation, the new PASOK government and its reform capacity, and the strength of Greek banks. Karamouzis, a self-proclaimed PASOK supporter and an American-educated economist who also has served as a Deputy CEO at the National Bank of Greece and a staff economist at the Bank of Greece (Greece's central bank), indicated the new government has inherited an economy on the brink of collapse and has very few options open to it to rein-in public finances and very little time to act before capital markets and the EU respond punitively. While major expenditure cuts are needed, Karamouzis is not optimistic that the new government has the capacity and willingness to undertake such measures. In his mind, the new government has 100 days to prove to Greek citizens and international markets that it has the capacity and willingness to implement painful reforms. But he believes that PASOK already lost a key opportunity when it failed to act quickly and decisively to end the 16-day strike by dockworkers opposed to the privatization of the Piraeus port (see reftel A). Karamouzis applauded Papandreou's decision to carve the Ministry of Finance from the Ministry of Economy, but he believes that the lines of authority have not been clearly delineated, which he believes will lead to conflict and confusion in the management of economic policy - something Greece can ill afford. Finally, on the health of Greek banks, Karamouzis asserted that with the "life-saving" interventions by the IMF in countries like Bulgaria and Romania, concerns about Greek bank subsidiaries in the Balkans were receding. Concerns about bank operations in Greece, however, were still high, since the impact of the crisis was only now beginning to be felt in the real economy. End Summary.

THE GREEK ECONOMY: TWIN CHALLENGES OF DEFICIT AND DEBT; GROWTH
PROSPECTS

12. (SBU) Karamouzis indicated in a recent conversation with DepEconCouns that dealing with Greece's twin deficits (e.g., the budget deficit and the public debt) is the most urgent and acute challenge facing the new government. He projects that public debt will reach almost 300 billion euros, or 115 percent of GDP, by the end of 2009 (according to new GoG data, the debt in 2008 was 99.2 percent of GDP; for 2009 through end-June, the level of debt had increased to 111.5 percent of GDP). The size of the interest component alone (12 billion euros for 2009) is challenging the government's ability to service it without resorting to further borrowing. [Note: A key factor in assessing whether a country's debt burden is sustainable is whether it can service the annual interest coming due without borrowing more and thereby adding to the debt load. End Note.] Rising interest rates, which are almost certainly around the corner in Karamouzis's view, will aggravate Greece's ability to continue to service this debt without continued borrowing.

13. (SBU) Karamouzis regards narrowing the budget deficit as crucial

if Greece is to continue to be able to service this debt and, ultimately, get on the path towards reducing it. Karamouzis explained that to comply with the 3 percent deficit cap under the EU's Growth and Stability Pact (SGP), Greece will need to find budgetary savings on the order of 18-20 billion euros over the next three years. Karamouzis underscored that because the government's new 2009 deficit projection (12.5 percent of GDP, or approximately 30 billion euros) was over half of the expected 2009 revenue base of 50-60 billion euros, finding these savings could not come from additional taxes alone. The government will need to implement major spending cuts in addition to improving tax collection and tackling tax evasion.

14. (SBU) Karamouzis believes that the economy will shrink this year by approximately 1.5 percent (GoG projects the same), despite factors that have supported demand and growth (e.g., a large budget deficit exacerbated by government spending and 2 percent growth in nominal wages). Notwithstanding a potentially strong recovery in the EU next year, he forecasts that the Greek economy will shrink again in 2010 by 0.5 to 1 percent as a result of flat real wages, a continued deceleration in credit, and the measures that the GoG must take to shrink the deficit.

IS THE NEW GOVERNMENT UP TO THE TASK?

15. (SBU) Karamouzis, who is a self-proclaimed PASOK supporter and claims he has close ties with many in the new government (including the Minister of Finance Giorgos Papakonstantinou and Minister of Citizens' Protection Michalis Chrysochoidis), is hoping for the best, but he sees a very difficult road ahead and increasingly limited options for the government. He regards this as the most difficult economic environment that Greece has faced in over 50 years, and it will require years of persistent, focused, and unpopular policies. PASOK, Karamouzis believes, has a very limited window of opportunity in which to act to convince Greek citizens and the markets that it is committed to undertaking serious public finance and structural reforms. In his opinion, the context in which the GoG acts will become increasingly constrained for several reasons: (1) a high level of frustration and low level of patience among people as a result of the lack of action taken by the previous government; (2) intensifying calls from the EU for immediate reforms; (3) weakening bargaining power with labor unions, as the Communist Party of Greece (KKE) and SYRIZA seek to

foment and take advantage of labor union discontent; and (4) increasing social discontent as people feel more personal impact from the crisis. If PASOK does not act decisively in the first 100 days, Karamouzis fears the government will lose popularity, the economic environment will continue to deteriorate, and it will be all the more difficult to sell reforms to an angry and disheartened public.

¶6. (SBU) While the new PASOK government has stated that it intends to narrow the budget deficit to a single digit in 2010 through a combination of measures, including aggressively fighting tax evasion, cutting spending and increasing taxes on only the wealthy, Karamouzis is not optimistic that PASOK will have the political room or willingness to implement these measures. He believes that spending cuts will be fought hard by PASOK traditionalists' desire to play to the party's established constituencies like labor and, in particular, the civil service. On tax evasion, he is not certain the GoG has the resolve and the technical capacity to solve the prolific problems that contribute to it. Finally, Karamouzis believes that there will be strong pressure to resort to additional taxes if it becomes increasingly clear that the other measures are simply too difficult to effect.

HANDLING OF THE PORT STRIKE: PORTENT OF THINGS TO COME?

¶7. (SBU) Karamouzis stated that he was disappointed by the GoG's handling of the recent strike by Port of Piraeus dockworkers protesting the privatization of the port's management to Beijing-based China Ocean Shipping Company (COSCO) Pacific (see reftel A). While he understands that Prime Minister Papandreou promised during the election campaign to reexamine various privatization deals negotiated by the previous government in order to gain the support of labor unions, he believes this rhetoric backfired on PASOK. In his opinion, it created an air of expectation and galvanized dockworkers to go back on strike (following months of relative quiet) with the aim of forcing the new government to abrogate the COSCO deal. Now that PASOK is in office, campaign rhetoric aside, Karamouzis would have liked to see PM Papandreou prioritize the needs of the Greek economy and all Greek citizens above the selfish demands of one small group. By acting quickly and decisively to quash the strike (Karamouzis did not suggest how the GoG might have done so), Papandreou could have shown investors that contract rights and foreign direct investment (FDI) were respected and supported. Karamouzis expressed concern that companies looking to invest their dwindling resources will interpret the GoG's actions as not business-friendly and decide against investing in Greece at a time when Greece desperately needs FDI to help it recover from the global financial crisis.

¶8. (SBU) Karamouzis also fears the "tentative" way the GoG dealt with a strike that had paralyzed Greece's busiest seaport and cost the Greek economy millions of euros a day plays right into the hands of other labor groups looking to exploit the GoG's pro-labor leanings. Karamouzis gave as an example a series of upcoming strikes by bank labor unions, which are seeking to force the government to enter into a collective bargaining agreement for automatic wage hikes. [Note: Collective bargaining agreements, which unite different unions seeking various benefits like wage increases against the GoG, are common in Greece. They often weaken the GoG's bargaining position by forcing it to deal with an entire sector's employees as a block versus dealing with each union on an individual basis. The IMF and others point to these collective agreements as a key constraint to improving competitiveness, as

they lead to wage hikes above the rates of inflation and productivity. End Note.] Unless PASOK gets tough on labor unions and their demands immediately, Karamouzis expressed fear that the KKE and SYRIZA will use labor discontent to challenge and goad PASOK to live up to its socialist ideals, making it more and more difficult for PASOK to achieve its stated reforms. This could reach a head by December, as Greece approaches the one-year anniversary of the shooting death by police of a teenager and the riots that followed.

THE NEW ECONOMIC MINISTRIES

19. (SBU) Karamouzis applauded PM Papandreou's move to separate the Ministry of Finance from the Ministry of National Economy and to create a new Ministry of Economy, Competitiveness and Merchant Marine. He is concerned, however, that the lines of authority have not been clearly delineated. According to Karamouzis's discussions with senior members of the government, Minister of Finance Giorgos Papakonstantinou will be responsible for revenues and spending, taxation policy, dealings with international institutions like the IMF and the European Commission, the finances of Greek state organizations, debt management, the stock exchange and banks, and overall economic policy. His GoG interlocutors have told him that the new Ministry of Economy is supposed to function like the U.S. Department of Commerce, with its new head, Louka Katseli, responsible for trade and commerce, competition policy, antitrust issues, and shipping issues. This division will only work, according to Karamouzis, if the two new ministers have good cooperation. Karamouzis shared frankly with DepEconCouns that the two Ministers in question are known to collide on a personality and

policy basis. According to Karamouzis, it is well known within PASOK that Katseli expected to become the "economy czar," with a range of power and responsibilities similar to that of her husband, Gerasimos Arsenis, who was the Minister of Economy and Finance and head of Greece's central bank in the early 1980s under PM Andreas Papandreou. Karamouzis thinks that PM Papandreou made the right choice in making Papakonstantinou responsible for the most important part of economic policy. He is viewed, according to Karamouzis, as more free-market minded, friendlier to investors, and more favorably by capital markets and ratings agencies. Katseli, on the other hand, Karamouzis indicated, is viewed as supporting more pro-labor and populist economic policies. Karamouzis stated that Katseli is supposed to have an undefined role in advising PM Papandreou on economic policy - a situation which he believes will create conflict and confusion in the management of economic policy - both of which Greece can ill afford at this crucial time.

BANKS: PASOK POLICIES TOWARDS; GENERAL HEALTH

10. (SBU) Despite PASOK's rhetoric while in the opposition and during the election to nationalize banks and their profits, Karamouzis does not believe PASOK will attempt to intervene in the market operation of Greece's banks. He thinks that, at most, PASOK will undertake the following vis-C -vis the banks: (1) impose an extra tax on banks' 2009 profits; (2) pass a consumer protection law that most banks favor as long as it does not encourage people to default on their debts; (3) support bank unions in their demands

for wage hikes; and (4) merge two state-owned banks (Agricultural Bank of Greece, or ATEBank, and Postal Savings Bank) to create a state-development bank along the lines of Germany's KfW (Reconstruction Credit Institute, formed after World War II as part of the Marshall Plan). Karamouzis believes without a doubt that the GoG also will appoint a new head of Greece's largest private bank, the National Bank of Greece (NBG). Karamouzis said that this is a tradition given that state pension funds control 17 percent of the NBG's stock, and it is not one PASOK is likely to forego. [Note: DepEconCouns has heard from two trusted sources at NBG that Karamouzis's name is being bandied about as the potential new head of NBG. End Note.]

¶11. (SBU) On the health of Greek banks in the aftermath of the global financial crisis, Karamouzis stated that the sector as a whole is doing well. Most large Greek banks are returning to profit, but these are the result more of trading activities in the capital markets and less traditional banking (mortgages, consumer lending, etc.). Credit expansion continues to decelerate for Greece as a whole, having fallen to 6 percent in August from 6.6 percent in July. Concerns over Greek bank subsidiaries in the Balkans have abated, according to Karamouzis, largely due to the various IMF interventions in the region, particularly in Romania and Bulgaria. Karamouzis indicated that Greek banks today are more concerned with the situation in Greece itself than that in the Balkans. This is due to the fact that the real economy in Greece has only begun to be hit by the effects of the global crisis. Eurobank and other Greek banks are watching non-performing loans (NPLs) carefully in Greece, fearing that as the economy continues to shrink and unemployment rises, more and more businesses and people will not be able to service their loans. Karamouzis outlined that Eurobank's NPL ratio for loans 90 days or more past due for the Balkans was deteriorating at a slower pace (6.5 percent at the end of the 3Q 2009), while its NPL ratio for Greece was beginning to deteriorate at a faster pace (5.5 percent at the end of 3Q2009). [Note: Eurobank EFG is the second largest bank in Greece in terms of both assets and deposits. It has a banking presence in Bulgaria, Serbia, Romania, Turkey, Poland, Ukraine, United Kingdom, Luxembourg, and Cyprus. Its loan-to-deposits ratio for the group as a whole at end 2Q2009 was 117 percent, while it was 143 percent in New Europe (Balkans, Turkey, Poland, Ukraine). The capital position of the group at the end of 2Q2009 is as follows: Total Tier 1: 10.2 percent; Total Capital Adequacy Ratio: 12.1 percent. End Note.]

COMMENT

¶12. (SBU) As a self-avowed supporter of PASOK, Karamouzis's views are a sign that the new government has its work cut out for it if it is to convince the Greek electorate and markets that it is able and willing to take on reforms. PASOK rhetoric has set the bar high regarding public expectations, potentially complicating the government's efforts to balance competing priorities.
Speckhard